Discovery Equity Fund

Market background

Global financial markets were broadly negative for the third quarter (Q3) of 2023. In the US, stronger economic growth, robust employment data and stubbornly high inflation increased the likelihood that the US Federal Reserve (Fed) would raise rates in November and maintain them through 2024. The shift saw Treasury yields reach their highest levels since 2007, with the yield on the benchmark 10-year US Treasury note rising by three-quarters of a percentage point. In Europe, the European Central Bank (ECB) raised its key interest rate to a record high of 4% in September, against the backdrop of higher consumer prices and slower economic growth. GDP growth in the region is now expected to stagnate in Q3 and remain subdued in the fourth quarter amid weaker manufacturing activity and a slowing services sector. Turning to China, the country's shaky economic recovery showed few signs of improving in Q3, with the government seeming reluctant to allocate significant funding to turn things around. In South Africa, turgid economic growth, lower commodity prices and declining exports of coal and iron ore have all contributed to the country’s looming fiscal crunch, weighing on investor sentiment. Investors remain concerned about holes in the nation’s budget, which the central bank said will force local rates to remain elevated for some time to come.

Performance review

The Fund delivered a negative absolute return for the quarter, underperforming its benchmark over the period.

The Fund’s offshore component weighed on relative returns over the quarter. Among the largest detractors from relative performance were holdings in Tapestry, TKO Group and Generac.

On the local side, the Fund’s underweight positions in Sasol and Capitec were key detractors over the period. Capitec’s share price rebounded after the release of its 1H24 results, where concerns about the company’s credit quality issues did not materialise. Management believes that the credit loss ratio for its retail book has peaked, with forward-looking credit quality indicators and coverage levels showing signs of stabilising.

Meanwhile, contributing to relative performance were underweight positions in Richemont and MTN. Richemont's share price fell as momentum in the luxury sector waned and valuation multiples derated off previous highs. China's economic data continued to show weakness over the quarter, while luxury spending across US consumers also softened, negatively impacting the outlook for luxury demand.

Significant purchases over the period included Old Mutual and Anglo Gold Ashanti, while significant sales included British American Tobacco and Naspers.

Outlook and strategy

The Fund's investment philosophy and process aim to deliver consistent returns for investors. We follow a multi-style investment approach which is dynamically adjusted to ensure that relative risk is actively managed throughout the business cycle. We prefer shares that are trading at a discount relative to the market.

Some of the portfolio's largest overweight positions include British American Tobacco and BHP Group, while significant underweights include FirstRand Bank and Sasol. British American Tobacco displays strong relative quality attributes, while BHP Group displays strong relative earnings momentum. In contrast, FirstRand displays weak relative quality attributes, while Sasol displays weak relative momentum.

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